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No. 90-692

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In the Supreme Court of the United States

OCTOBER TERM, 1990

VICTOR ROGERS AND LOREN SINGLETARY,
PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION,
AS RECEIVER FOR FIRST REPUBLICBANK HOUSTON,
N.A., AND NCNB TEXAS NATIONAL BANK

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held that petitioners may not bring claims against the Federal Deposit Insurance Corporation and the successor to a failed bank based on alleged violations of the federal securities laws by the officers of the closed bank.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	6
Conclusion	12

TABLE OF AUTHORITIES

Cases:

American City Bank & Trust Co., N.A., In re, 402 F. Supp. 1229 (E.D. Wis. 1975)	8
Astrup v. *Midwest Federal Savings Bank*, 886 F.2d 1057 (1989)	10
Bateman Eichler, Hill Richards v. *Berner*, 472 U.S. 299 (1985)	8
Beighley v. *FDIC*, 868 F.2d 776 (5th Cir. 1989)	4, 5, 6
Bradley v. *Richmond School Board*, 416 U.S. 696 (1974)	9
Cook County Nat'l Bank v. *United States*, 107 U.S. 445 (1883)	8
D'Oench, Duhme & Co. v. *FDIC*, 315 U.S. 447 (1942)	3, 5, 6
FDIC v. *Aroneck*, 643 F.2d 164 (4th Cir. 1981)	10
FDIC v. *Investors Associates X., Ltd.*, 775 F.2d 152 (6th Cir. 1985)	5, 7, 10
FDIC v. *Kasal*, 913 F.2d 487 (8th Cir. 1990)	9
FSLIC v. *Lafayette Investment Properties, Inc.*, 855 F.2d 196 (5th Cir. 1988)	7
FSLIC v. *Murray*, 853 F.2d 1251 (5th Cir. 1988)	7, 8
Gilman v. *FDIC*, 660 F.2d 688 (6th Cir. 1981)	10
Gunther v. *Hutcheson*, 674 F.2d 862 (11th Cir.), cert. denied, 459 U.S. 826 (1982)	10-11
Langley v. *FDIC*, 484 U.S. 86 (1987)	3, 4, 6, 10, 11
McLemore v. *Landry*, 898 F.2d 996 (5th Cir.), cert. denied, 111 S. Ct. 428 (1990)	7, 8
Olney Savings & Loan Ass'n v. *Trinity Banc Savings Ass'n*, 885 F.2d 266 (5th Cir. 1989)	4

Cases—Continued: Page

Oppenheimer v. *Harriman Nat'l Bank & Trust Co.*, 301 U.S. 206 (1937) 11
Pinter v. *Dahl*, 486 U.S. 622 (1988) 8
Unisys Corp. v. *FDIC*, 724 F. Supp. 454 (W.D. Tex. 1988) 8
Vernon v. *Resolution Trust Corp.*, 907 F.2d 1101 (11th Cir. 1990) 11

Statutes:

Financial Institutions Reform, Recovery and Enforcement Act, Pub. L. No. 101-73, 103 Stat. 183:
§ 212, 103 Stat. 231 (12 U.S.C. 1821(d)(9)(A)) 9
§ 214, 103 Stat. 249 (12 U.S.C. 1821(n)(4)(I)) 9
§ 217, 103 Stat. 256-257 (12 U.S.C. 1823(e)) 3, 4, 6, 9, 11

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-24a) is reported at 907 F.2d 1523. The opinion of the district court (Pet. App. 25a-30a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 25, 1990. A petition for rehearing was denied on August 21, 1990. Pet. App. 31a-32a. The petition for a writ of certiorari was filed on October 24, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioners are investors who executed promissory notes in favor of First RepublicBank, Houston, N.A. (FRB), a financial institution that is now insolvent. Petitioners contend that the promissory notes are invalid because they were obtained by FRB through fraud in violation of the federal securities laws.

More specifically, petitioners allege that, beginning in 1983, FRB assisted John C. Riddle and Jeffries C. Suttles, who were heavily indebted to FRB, in a scheme to defraud investors. FRB helped the two men open two branch banks of Texas National Bank (TNB) by lending investors, including petitioners, money for the purchase of TNB stock. The investors executed promissory notes in favor of FRB, thereby allowing FRB to acquire new collateral for the debts owed to it by Riddle and Suttles. Petitioners contend that FRB never told them that the TNB stock was subject to a voting trust giving control of the stock to Riddle and Suttles. They further assert that FRB encouraged and financed large TNB stock purchases, including their purchases, knowing that the stock was overvalued and that the TNB branch banks were doomed to fail. Pet. App. 2a-3a.

In 1987, Riddle and Suttles defaulted on their note for the purchase of one of the TNB branch banks, and both TNB branch banks failed shortly thereafter. In May 1988, petitioners, as stockholders of the TNB branch banks, filed this federal securities fraud action in a federal district court against Riddle, Suttles, and FRB.[1] In July 1988, FRB also

[1] The FDIC, as receiver for one of the failed TNB branches, participated in other litigation involving the TNB branches and FRB. Pet. App. 3a.

failed, leading to the appointment of the FDIC as its receiver. The FDIC subsequently sold some of FRB's assets, including petitioners' promissory notes, to respondent North Carolina National Bank—Texas (NCNB). The FDIC and NCNB were then substituted as defendants in place of FRB in this case.

The FDIC and NCNB filed counterclaims against petitioners seeking enforcement of the promissory notes and moved for summary judgment. The FDIC and NCNB claimed that the federal common law doctrine set forth in *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), and later cases, barred petitioners' securities fraud claims. In addition, the FDIC and NCNB contended that the rule of *D'Oench* barred petitioners' defenses against enforcement of their notes. The district court granted summary judgment in favor of the FDIC and NCNB. Pet. App. 25a-30a.

2. The court of appeals affirmed. Pet. App. 1a-24a. It found this Court's recent decision in *Langley* v. *FDIC*, 484 U.S. 86 (1987), particularly instructive. In that case, decided under *D'Oench*'s statutory counterpart, 12 U.S.C. 1823(e),[2] the Court rejected

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[2] 12 U.S.C. 1823(e) provides:

> No agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by it under this section or section 1821 of this title, either as security for a loan or by purchase or as receiver of any insured depository institution, shall be valid against the Corporation unless such agreement—(1) is in writing, (2) was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution, (3) was approved by the board of directors of the depository institution or its loan committee, which approval shall be

the contention "that the word 'agreement' in [Section 1823(e)] encompasses only an express promise to perform an act in the future." 484 U.S. at 90. Rather, the Court held that the term also includes the representations and conditions that formed the basis of the bargain. *Id.* at 91. Accordingly, the Court in *Langley* rejected a claim that a mortgage was unenforceable by the FDIC because the bank that executed the mortgage had induced it by making fraudulent misrepresentations. The court below found that "[e]xcept for the fact that the asset in this case is stock rather than land, and its sale thus regulated by federal law, the cases are the same." Pet. App. 11a.[3] The court of appeals held that borrowers like petitioners "who execute facially unqualified obligations may not prevent a federal receiver's collection efforts by claiming that they were induced

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reflected in the minutes of said board or committee, and (4) has been, continuously, from the time of its execution, an official record of the depository institution.

[3] The court of appeals noted that this case was brought before Section 1823(e) was amended to protect the FDIC in its capacity as receiver. The court held that it did not have to decide whether that change in the statute applied in this case because "[t]here are two *D'Oench, Duhme* doctrines, one statutory (12 U.S.C. § 1823(e)) and one of common law," and the common law rule has long been applied to protect the FDIC in its capacity as receiver. Pet. App. 7a n.4. The court added that "[c]ourts often consider the *D'Oench, Duhme* doctrine and § 1823(e) in tandem." *Ibid.*, quoting *Beighley* v. *FDIC*, 868 F.2d 776, 784 (5th Cir. 1989). See also *Langley*, 484 U.S. at 92-93 (construing "agreement" in Section 1823(e) in light of *D'Oench*); *Olney Savings & Loan Ass'n* v. *Trinity Banc Savings Ass'n*, 885 F.2d 266, 274 (5th Cir. 1989) ("[a]s the aims of § 1823(e) and *D'Oench* are identical * * * the reasoning applied in § 1823(e) cases is applicable to *D'Oench* cases").

to execute the obligations by fraud." Pet. App. 9a-10a.

The court of appeals then explained in more detail why the fact that stock is involved in this case does not distinguish it from *Langley*. The court noted (Pet. App. 11a-12a) that it had previously rejected similar arguments based on state common law fraud claims in *Beighley* v. *FDIC*, 868 F.2d 776, 784 n.12 (5th Cir. 1989), and that the only court of appeals to decide the question had held in *FDIC* v. *Investors Associates X., Ltd.*, 775 F.2d 152, 156 (6th Cir. 1985), that claims based on the federal securities laws were also barred. Those decisions were correct, the court stated, because the basic principle underlying the *D'Oench* doctrine, "which is of particular relevance today," is that it is "federal policy to protect [the FDIC] *and the public funds which it administers* against misrepresentations as to the securities or other assets in the portfolios of the banks which [it] insures." Pet App. 13a, quoting *D'Oench, Duhme*, 315 U.S. at 457. The court added that "precluding this action does not deprive the plaintiffs of protection under the federal securities laws" since "[t]hey may sue the individuals who actually defrauded them." Pet. App. 12a-13a. In that connection, the court noted, while the federal government insures bank deposits, "there is no federal policy of protecting investors by the government underwriting of privately issued securities." *Id.* at 13a.[4]

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[4] Judge Brown dissented. In his view, *Langley* is distinguishable because petitioners do not allege fraud in the inducement. Pet. App. 18a. In addition, he contended that the other cases rejecting defenses based on state law were grounded on the principle that there is a need "for a uniform federal rule when dealing with the FDIC," a principle that

ARGUMENT

The court of appeals correctly applied settled principles of law in deciding this case, and its holding does not conflict with any decision of this Court or any other court of appeals. Moreover, the decision in this case has limited prospective importance in light of amendments to the federal banking laws. Further review is therefore not warranted.

1. The *D'Oench* doctrine and its statutory counterpart, 12 U.S.C. 1823(e), protect the FDIC from a bank's misrepresentations concerning its assets and from unrecorded side agreements that are not reflected in a bank's records. 315 U.S. at 457. In *D'Oench*, this Court specifically held that the maker of a promissory note cannot defend against the FDIC's enforcement of the note when the maker has "lent himself to a scheme or arrangement whereby the banking authority * * * was or was likely to be misled." *Id.* at 460. The doctrine has been " 'extended considerably by the courts' since the 1942 decision." *Beighley*, 868 F.2d at 784. As the court of appeals stressed, in *Langley* this Court held that a misrepresentation to borrowers concerning a condition under which a loan is made constitutes fraud in the inducement, and a borrower may not defend against enforcement of the agreement in an action brought by the FDIC on the basis of such misrepresentations. 484 U.S. at 93-94. In addition, in light of this Court's decision in *Langley*, the courts of appeals have repeatedly held under the common law rule of *D'Oench* that a bank's misrepresentations to borrowers cannot be asserted as a defense to recovery by

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is inapplicable in a case involving allegations of violations of the federal securities laws. *Id.* at 23a.

federal authorities on facially unqualified notes. *McLemore* v. *Landry*, 898 F.2d 996, 1002 (5th Cir.), cert. denied, 111 S. Ct. 428 (1990); *FSLIC* v. *Lafayette Investment Properties, Inc.*, 855 F.2d 196, 198 (5th Cir. 1988); *FSLIC* v. *Murray*, 853 F.2d 1251, 1255 (5th Cir. 1988). And as the court of appeals noted in its opinion, the Sixth Circuit held that *D'Oench*'s bar to misrepresentation claims and defenses applies to "fraud in the inducement" arguments based on the federal securities laws. Pet. App. 11a-12a, citing *FDIC* v. *Investors Associates X. Ltd.*, *supra*.

Petitioners contend (Pet. 9) that *Langley* is inapplicable because they do not allege fraudulent inducement. However, the factual predicate of their claim, as presented in their petition (Pet. 5), is that FRB—knowing that the TNB stock was overpriced and eroding in value—nevertheless encouraged and financed petitioners' purchase of TNB stock. The obvious import of such an allegation is that FRB fraudulently induced petitioners to purchase TNB stock by withholding critical information. As the court of appeals observed, except for the fact that the asset in this case is stock rather than land, petitioners have asserted a fraud in the inducement action essentially indistinguishable from that barred under *Langley*. Pet. App. 11a.[5]

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[5] Petitioners further argue (Pet. 10-11) that their claim should be analogized to fraud in the factum because it is based on the federal securities laws, which provide that agreements are "void" rather than "voidable" in certain circumstances. Similar attempts to cloak a fraud in the inducement claim in the guise of a fraud in the factum claim have been given short shrift by the courts, which have properly looked to the facts of the case. For example, in *McLemore* v. *Landry*, the Fifth Circuit held that where borrowers had

Petitioners also contend (Pet. 12-15) that because their claim is based on the express statutory provisions of the federal securities laws, resort to federal common law doctrines such as *D'Oench* is precluded. This Court, however, has recently held that common law defenses may be available in limited situations to defeat express and implied statutory securities fraud claims. *Pinter* v. *Dahl*, 486 U.S. 622, 633-639 (1988); *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 306-311 (1985).

More to the point, petitioners' argument is mistakenly premised on the claim that the body of law related to its fraud claim is limited to investor rights under the federal securities laws. But the question presented also relates to what powers are available to the FDIC, as successor to an insolvent financial institution, in disposing of claims formerly made against the institution. Congress has enacted a comprehensive legislative scheme to provide the FDIC with broad remedial powers as the successor to failed institutions, and all persons with claims against insolvent institutions must look to this scheme to determine their rights and duties. *Unisys Corp.* v. *FDIC*, 724 F. Supp. 454, 457 (W.D. Tex. 1988); *In re American City Bank & Trust Co., N.A.*, 402 F. Supp. 1229, 1231 (E.D. Wis. 1975); see also *Cook County Nat'l Bank* v. *United States*, 107 U.S. 445, 448 (1883). And that legislative scheme has consistently been interpreted in light of this Court's decision in *D'Oench, Duhme*, which retains independent force. See note 3, *supra*.

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knowledge of the character or terms of the loan document, fraudulent misrepresentations that induced borrowers into signing for the loan fell within the scope of *Langley*. 898 F.2d at 1002; see also *FSLIC* v. *Murray*, 853 F.2d at 1255.

In addition, Congress has recently augmented the federal laws governing financial institutions by enacting the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), Pub. L. No. 101-73, §§ 212, 214, 217, 103 Stat. 183, 231, 249, 256-257 (1989). In FIRREA, Congress made clear that claims such as those advanced by petitioners are not valid against the FDIC or bridge banks like NCNB. It did so by providing that Section 1823(e) applies when the FDIC acts as a receiver; by adding 12 U.S.C. 1821(d)(9)(A), which provides that "any agreement which does not meet the requirements set forth in section 1823(e) of this title shall not form the basis of, or substantially comprise, a claim against the receiver or the Corporation"; and by enacting similar protections for bridge banks in 12 U.S.C. 1821(n)(4)(I). There is no exception to these provisions for claims based on federal laws. Since under *Langley* petitioners' fraudulent inducement claims constitute part of their "agreement," but the fraudulent statements were not recorded, their defenses against the FDIC are barred by Section 1823(e). Similarly, their causes of action against the FDIC are barred by Section 1821(d)(9)(A) because "the basis" of their claim is the unrecorded fraudulent inducement. And NCNB has similar protections under Section 1821(n)(4)(I).[6]

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[6] Although the court of appeals decided not to reach the issue (Pet. App. 7a n.4), these protections may be applied in a pending case like this one. FIRREA §§ 212, 217, 103 Stat. 231, 256; *Bradley v. Richmond School Board*, 416 U.S. 696, 715 (1974); *FDIC* v. *Kasal*, 913 F.2d 487, 493 (8th Cir. 1990).

2. Petitioners mistakenly assert (Pet. 15-20) that the decision of the court of appeals conflicts with the holdings of other courts of appeals.

Three of the cases cited by petitioners as presenting a conflict are clearly inapposite. In *Gilman* v. *FDIC*, 660 F.2d 688, 693-695 (1981), the Sixth Circuit ruled in favor of the FDIC and did not even address the issue raised by petitioners.[7] Similarly, in *FDIC* v. *Aroneck*, 643 F.2d 164 (4th Cir. 1981), the FDIC did not even raise the rule of *D'Oench*. And in *Astrup* v. *Midwest Federal Savings Bank*, 886 F.2d 1057, 1059-1060 (1989), the Eighth Circuit held that while *D'Oench* affords no protection against tort claims, it does preclude recovery on the basis of agreements that contradict the records of the insolvent institution. As this Court recognized in *Langley*, a fraudulent inducement claim is premised on an undisclosed agreement or condition (484 U.S. at 93), and such a claim is therefore based on contract, not tort. In this case, like *Langley*, petitioners' claim is based on unrecorded representations that allegedly induced petitioners to enter into a contract.[8]

Petitioners also claim that two decisions of the Eleventh Circuit, *Gunter* v. *Hutcheson*, 674 F.2d 862,

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[7] Moreover, in its later decision in *FDIC* v. *Investors Associates X., Ltd.*, 775 F.2d at 155-156, the Sixth Circuit expressly rejected federal securities law defenses on the basis of the *D'Oench* doctrine.

[8] Petitioners also assert (Pet. 16) that the decision of the court of appeals conflicts with this Court's decision in *Oppenheimer* v. *Harriman Nat'l Bank & Trust Co.*, 301 U.S. 206 (1937). However, the decision in *Oppenheimer* predates this Court's decision in *D'Oench*, and the case did not involve, nor did this Court address, the protections afforded the FDIC as successor to a failed financial institution. See Pet. App. 5a n.3.

cert. denied, 459 U.S. 826 (1982), and *Vernon* v. *Resolution Trust Corp.*, 907 F.2d 1101 (1990), support its position. However, in *Gunter* the Eleventh Circuit held that the FDIC had a defense under the federal securities laws to the plaintiffs' claims and affirmed the dismissal of those claims on that independent basis. 674 F.2d at 874-877. Similarly, in *Vernon* the Eleventh Circuit affirmed the dismissal of claims against a financial institution that had entered into a purchase and acquisition agreement with the Federal Savings and Loan Insurance Corporation on the basis of the terms of the agreement. 907 F.2d at 1108. Accordingly, the Eleventh Circuit's comments with respect to the rule of *D'Oench* were not necessary to its holdings.[9]

3. Finally, review is not warranted since the question presented has a relatively limited impact. First, as the prior discussion of the decisions of other courts of appeals shows, the FDIC has a variety of defenses available to it in cases like this other than the rule of *D'Oench*. Thus, as the dissenting judge stated, "[i]n the vast majority of cases" plaintiffs such as petitioners would not prevail in any event. Pet. App. 24a.

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[9] Moreover, the decision in *Gunter* preceded this Court's decision in *Langley*, and the Eleventh Circuit's conclusion that certain fraudulent representations were not part of the relevant "agreement" within the meaning of Section 1823(e) is contrary to this Court's conclusion (484 U.S. at 90-91) that "agreement" includes the representations and conditions made in connection with the bargain. In *Vernon*, the Eleventh Circuit distinguished a number of decisions on the ground that they involved "the validity and enforceability of a particular debt or monetary obligation," such as "a promissory note." 907 F.2d at 1107. This case is accordingly distinguishable under the logic of the court since the enforceability of promissory notes is at issue.

Second, even if the recent amendments to the federal statutes governing financial institutions are not applicable in this case (see note 6, *supra*), they resolve the issue prospectively.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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